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UNCLAS SECTION 01 OF 04 CARACAS 000470

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TREASURY FOR KLINGENSMITH AND NGRANT  
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SUBJECT: FOOD SECURITY IN THE BRV: MERCAL'S WOES

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11. (SBU) Summary: Mission Mercal, the BRV's subsidized food distribution network, is plagued with corruption, inefficiency, and mismanagement. Shortages in basic staples have developed in large part because Mercal has fallen 2-3 months behind in imports. Once the poster child of the BRV's mission program, Mercal's popularity has plummeted from over 90 percent to 64 percent and is reaching fewer Venezuelans with fewer products. Chavez realizes that he needs Mercal in order to maintain his government's popularity. Rather than tackle the hard questions of economic distortions and inefficiencies, Chavez will most certainly pump money into Mercal until the shelves are re-stocked, regardless of the real economic cost and waste. It is unclear in the longer run whether the Mercal program can recoup its prior popularity and level of distribution, given the BRV's increasing financial commitments in all areas and lower average oil prices. End Summary.

12. (SBU) Mercal had earned high marks from Venezuelans as the BRV's most popular mission. Customer satisfaction, as measured by the consulting firm Datanalysis, reached above 90 percent in early 2006. There were also indications that the low-cost food chain had penetrated middle-class neighborhoods (Reftel B). According to a recent survey by Datanalysis in January 2007, Mercal's popularity has dropped from 74 percent to 64 percent in only five months. Luis Vicente Leon, Director of Datanalysis, said that the reasons for the steep drop were shortages of basic foods.

13. (SBU) Statistical trends show a downward slope in Mercal's efficiency; it is distributing less food to fewer customers. According to statistics of the Ministry of People's Power of Food (MINPPAL), the number of Venezuelans served by Mercal dropped from over 15 million to under 10 million from 2005-2006, a 41.5 percent decline. Since April 2006, food sales at Mercal have steadily declined and November 2006 sales totaled half of those in April 2006.

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Econoffs visit Mercal  
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14. (SBU) Econoffs recently visited seven Mercals for a firsthand look in low and low-middle income areas of Caracas. Mercal customers can expect to find shortages in basic staples. It would be impossible to prepare even the most basic meal with the selection available at a Mercal. Chicken, eggs and milk were not available in any of the seven

stores we visited. Pasta, black beans and sugar --all Venezuelan staples -- were available in only two stores. In one store that had sugar, there were 75-100 customers waiting outside on a slowly moving line. When econoffs were driving through Caracas and asked a man on the street where the nearest Mercal was, he pointed over his shoulder but cautioned, "Don't go to that one because there's nothing there!" He then suggested econoffs head back to the store we had just visited, which also had a meager selection. Consistent with econoffs' experiences, the daily newspaper El Universal reported recently that customers complain when milk, sugar, and chicken are actually available, "everyone tells everyone" and the merchandise immediately disappears.

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What about Imports?  
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¶5. (U) One explanation for Mercal's shortages is lack of imports. According to El Universal, a source in MINPPAL said that CASA, Mercal's purchasing arm, has not executed a single import in the past three months, dating back to a sugar shipment received in November 2006. The report notes that, prior to this shipment, other imports such as milk, chicken, and beans, were paralyzed. (Note: An estimated 68-70 percent of food consumed in Venezuela is imported or processed from imported raw materials. End Note.) Though Chavez has stressed the importance of making Venezuela less reliant on foreign products, Mercal still claims to import about 30 percent of its merchandise, though the actual figure is probably closer to 70 percent.

¶6. (SBU) Purchases for foodstuffs on the international market are generally executed as forward contracts 2-3 months

CARACAS 00000470 002 OF 004

in advance of delivery. This makes it difficult to quickly import in an emergency if shortages develop. According to a contact within the Venezuelan Association of Rice Millers, the former Minister at MINPPAL, Erika Farias, did not understand how forward contracts worked. Our source described Farias as "a 23 year old totally in over her head."

She said there was no rice on Mercal's shelves because no purchase orders had been placed in the past two months.

¶7. (SBU) A shipping executive confirmed to econoff CASA's sharp decline in imports, indicating that the main reason was failure to execute forward contracts. According to this executive, CASA typically imports 140,000 tons of food per month. In November 2006, the number dropped to 55,000 tons and dipped even further to 40,000 tons in December. From September to December 2006, CASA did not execute any forward contracts to purchase food and, consequently, fell three months behind in purchase orders.

¶8. (SBU) On February 25, MINPPAL provided rare public statistics for CASA and Mercal. While designed to show CASA is on the mend, these numbers actually confirmed CASA's import problems. CASA has recently increased its daily supply to Mercal from 1,400 tons of food to 4,000 tons. Assuming a 30-day month, this means that CASA had been supplying Mercal only 42,000 tons of food monthly, which tracks the statistics we received regarding CASA's sharp decline in imports (see paragraph 7).

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Buhoneros: The Cause of All Evil?  
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¶9. (U) Another cause for the shortages is that buhoneros (street merchants) buy Mercal products in short supply at subsidized prices and re-sell them at several times the Mercal price. We have heard that some buhoneros are tapped into the institutionalized fraud in Mercal and can obtain the products before they ever reach the stores. In a recent

speech, Chavez complained that street merchants were selling Mercal products at high prices and warned, "This is one of the accusations and we need to attack it." Chavez announced a decree banning CASA products from being sold outside of the Mercal chain. In a recent report on Mercal in the Chavista newspaper "Vea," street merchants were made scapegoats for supply and distribution problems and portrayed as greedy "capitalists." A Mercal supervisor is quoted as saying, "I don't think that any real Mercal leader - really involved in the Mission and its essence - would hoard food. We know that there are businesspeople who prefer to fill their bags at the expense of others' necessity. It's this type of corruption that we need to fight against."

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The BRV's Reaction  
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¶10. (SBU) Chavez is clearly concerned about Mercal. On February 27 during his daily "Alo Presidente," he announced a USD 278 million package to support Mercal. On January 27, Chavez called on Farias to make a "superhuman effort" to improve Mercal. Chavez appeared genuinely upset and puzzled, as he questioned, "How is it that Mercal is distributing less than before?" Two days after Chavez criticized Farias, he replaced her with General Rafael Oropeza as Minister at MINPPAL and Omar Duarte, also a military man, took the reins of CASA. Oropeza and Duarte previously worked together in the same positions from 2004-2006, during Mercal's period of expansion. Oropeza said that Mercal's problem was not at the point of sale and that shortages were attributable to "other causes" in the Mercal system. Mercal has recently launched an initiative of selling CASA products from small stands within urban markets that has already drawn the ire of established merchants.

¶11. (SBU) The BRV has tried to counter criticism of Mercal and, in doing so, has tongue-tied itself in double-speak. Over the first weekend in February, MINPPAL organized an "outside market" for Mercal products, known as "Megamercal." Vice President Jorge Rodriguez visited the market and took the opportunity to turn it into a propaganda event, proclaiming "this market is the proof that there are no shortages. We have sold 50 thousand kilos of chicken and have the capacity to sell 50 thousand more." In a separate statement, Interior Minister Pedro Carreno contradicted Rodriguez, saying the BRV would investigate hoarding. Last week, Chavez signed the first decree under the Enabling Law

CARACAS 00000470 003 OF 004

to criminalize hoarding in price-regulated products (Reftel C).

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The Industry's Viewpoint: Corruption and Mismanagement  
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¶12. (SBU) Corruption has reportedly become rampant in the Mercal system. In November 2006, Ramon Rengifo, the sole opposition member of the Legislative Council of Aragua State, denounced corruption in Mercal. He estimated loss through fraud at Bs 6 billion (approximately USD 2.9 million) between September 2005 and January 2006. "There are many administrative people in Mercal that are involved because they think that it is their patrimony because the President says so," said Rengifo. Rengifo said that the investigation was being handled by Mercal's internal auditors and was in the hands of the BRV's general accounting office, without any answers to date.

¶13. (SBU) Agricultural Counselor and econoff met separately with Jose Anzola, Director of Food Logistics at Empresas Polar, Venezuela's largest private food distributor, and Jorge Macedo, President of Central Madeirense, Venezuela's largest supermarket chain. Both Anzola and Macedo told us that the biggest problem in Mercal is pervasive corruption

and incompetence on every level, beginning with the hopelessly incompetent former MINPPAL Minister Farias. Anzola estimated that corruption and inefficient management cost Mercal approximately 30 percent of revenue. He also said that Mercal's inability to import stemmed from mismanagement and CASA's inability to pay suppliers and producers on a timely basis. Macedo agreed that Mercal was hopelessly inefficient and corrupt and told us that entire truckloads of deliveries often never arrive at the Mercal stores and are entirely sold off by employees and occasionally, the National Guard.

¶14. (SBU) Anzola and Macedo both expected the BRV to continue to pump money into Mercal. When asked if Mercal would recover, both Anzola and Macedo concluded that it has to, for Chavez' sake. They anticipated that Chavez would continue to throw money at Mercal until the system regained its function, or rather, seemed to function. Macedo, however, expressed skepticism that Mercal's popularity would ever climb back to the 90 percent range. He argued that while Mercal benefited from its originality and rock-bottom prices, Venezuelan customers preferred supermarkets for better service, air-conditioning, product selection, and brand name availability.

¶15. (SBU) While agreeing that providing low-cost food to the poor is a worthy social goal, Anzola took issue with the politicized way that the BRV has gone about the project. He cited, for example, the prevalence of the military in Mercal and CASA management as opposed to experienced purchasers with private sector backgrounds. (Note: As we previously reported, Chavez has publicly welcomed Cuban participation in Mercal. During an April 2006 "Alo Presidente," Chavez said that Mercal existed thanks to the help of Cuban experts (Reftels). End Note.)

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Comment  
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¶16. (SBU) Mercal's woes are indicative of the "black box" economics of the BRV. Mismanagement and corruption siphon off money and goods as they move through the system, with neither institutional transparency nor individual accountability to control the process. The end product is less than the sum of its parts, resulting in waste and economic distortions. Disciplined economics would suggest that the BRV try to understand the root causes of Mercal's problems - corruption, mismanagement, and retrograde pricing policies. The more likely outcome is that Chavez will keep pumping money into Mercal until there is food on the shelves, regardless of the program's real cost. An approval rating for a program that offers cheap food hovering at 60 percent is indicative of a serious problem. Consumers' inability to buy staple products because Mercal cannot stock its shelves is a major embarrassment to the BRV and Chavez has taken this personally. Mercal needs to deliver the goods - literally - for Chavista propaganda to continue to resonate. With lower average oil prices and ballooning BRV commitments, the long-term sustainability of Mercal is a major question mark.

CARACAS 00000470 004 OF 004

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